India Midcaps

VISIT NOTE

VIP INDUSTRIES

Strong sales; manufacturing to drive margins

India Equity Research| Miscellaneous

Edelweiss
Ideas create, values protect

We met Mr. Dilip Piramal, MD, VIP Industries (VIP) to gain insight about the company's strategies. Management sounded optimistic on the sales growth (~15%), driven by strong travel industry (particularly air travel) and low penetration of branded luggage (20-25%), having regained share from peer Samsonite in past 2 years. While margins may be under pressure in near term due to higher tax rate under GST (28% versus 18% earlier) and cost pressures in China, VIP's dominant position will allow passing these on (effected 6% price hike in June). Further, rising share of manufacturing with doubling of capacity in Bangladesh subsidiary (20% PAT margin) will support margins. With uptick in discretionary spending, ~50% market share in underpenetrated luggage market with a portfolio of brands, and shifting focus towards manufacturing versus trading, we upgrade our FY19E earnings by 5% and P/E to 30x (24x earlier), at 10% discount to higher band. We expect VIP to post 15% sales and 29% PAT CAGR over FY17-19 with strong 808bps RoCE expansion to 41%. Maintain 'BUY' with a revised target price of INR295 (INR225 earlier).

Strong structural growth drivers

Demand drivers remain strong with air traffic growing at 15-20% and branded luggage penetration at ~25%. Management guided 2-2.5x growth of GDP is attainable with guidance of mid-teens growth. VIP has regained share from peer Samsonite in past 2 years. *Skybags* and hypermarkets continue to be the strongest growth drivers.

Shifting strategy towards manufacturing to support margins

While there is some uncertainty in margins in short term due to 10% higher tax rate under GST and cost increase demanded by Chinese suppliers (due to rising labour costs), VIP can pass on the cost increases, as demonstrated by 6% price hike which market has absorbed. Further, focus shifting to manufacturing (INR250mn capex announced in Bangladesh doubling capacity) will increase manufacturing margins.

Outlook and valuations: Profitable growth ahead; maintain 'BUY'

With strong drivers (air traffic growth, improving market share) and shifting focus towards manufacturing from trading, we raise our FY19E earnings by 5% and P/E to 30x. Maintain **'BUY'**. At CMP, the stock is trading at 25.2x FY19E EPS.

Financials

Year to March	FY16	FY17	FY18E	FY19E
Revenues (INR mn)	12,165	12,752	14,536	16,974
EBITDA (INR mn)	1,079	1,318	1,632	2,116
Adjusted Profit (INR mn)	665	839	1,060	1,391
Adjusted Diluted EPS (INR)	4.7	5.9	7.5	9.8
Diluted P/E (x)	52.8	41.9	33.1	25.2
EV/EBITDA (x)	32.6	26.0	20.8	15.9
ROAE (%)	20.6	22.4	24.3	27.9

EDELWEISS RATINGS

Absolute Rating	BUY
Investment Characteristics	Growth

MARKET DATA *(R: VIPI.BO, B: VIP IN)*

CMP	: INR 248
Target Price	: INR 295
52-week range (INR)	: 269 / 112
Share in issue (mn)	: 141.3
M cap (INR bn/USD mn)	: 35 / 546
Avg. Daily Vol. BSE/NSE ('000)	: 535.0

SHARE HOLDING PATTERN (%)

	Current	Q4FY17	Q3FY17
Promoters *	52.5	52.5	52.5
MF's, FI's & BKs	16.5	16.8	17.9
FII's	4.4	4.2	3.3
Others	26.6	26.5	26.3

** Promoters pledged shares (% of share in issue) : NIL*

PRICE PERFORMANCE (%)

	BSE Midcap Index	Stock	Stock over Index
1 month	5.9	27.4	21.5
3 months	8.4	27.4	18.9
12 months	22.7	94.6	71.9

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September 20, 2017

Key highlights of the meeting

Growth drivers

- Management guided that their growth could be as high as 2-2.5x of GDP growth.
- Demand remains strong. Travel trend remains positive with air travel growing at 15-20% in the recent past, while auto industry is also doing well pointing to improved road travel. Marriage season is also a big driver.
- Branded luggage penetration is at mere ~25%. Hence, management believes the big driver will be growth of the market itself as penetration rises. VIP's strong market share (~50%) will allow it to capture growth of industry.
- VIP has regained share from peer Samsonite in past 2 years.

Table 1: VIP sales growth has been outperforming Samsonite (%)

Companies	Q1FY16	Q2FY16	Q3FY16	Q4FY16	Q1FY17	Q2FY17	Q3FY17	Q4FY17	Q1FY18
VIP	7.6	35.0	15.0	11.8	3.5	(3.4)	5.5	11.6	9.0
Samsonite	12.6	12.1	9.9	1.8	0.4	8.1	(12.3)	9.0	(5.2)

Source: Company, Edelweiss research

- International business could also be a strong driver going forward as the company looks outside India for its manufactured products. Further, manufacturing in China is largely for soft luggage. Hence, hard luggage (which VIP manufactures in India) could be a big opportunity in exports.
- Management guided revenue growth could be in mid-teens (~15%) going ahead.

Margins

- GST may impact margins negatively as the tax rate is ~10% higher. To offset this, VIP has taken a 6% price hike and may look for further 2-3% hikes. However, management explained that the market has absorbed these price hikes due to the growing discretionary demand.
- Further, Chinese suppliers have demanded a cost increase of ~5%. This is on account of rising labour costs and crackdown on environmental norms violations. Negotiations are underway, though management believes they have strong bargaining power due to their large volume of sourcing from China. Around 60-65% of sourcing is from China.
- However, with rising focus on manufacturing in India and Bangladesh (currently around 20% and less than 5% of sourcing respectively), inclusion of manufacturing margins will prop up gross margin.
- Manufacturing operations in Nashik turned profitable last year after years of losses. Hence, it will now start adding to margins rather than taking away from it.
- VIP continues to work with Vector Consulting to bring efficiencies in its supply chain and optimise logistics costs. Further, VIP will invest INR150-180mn in a central warehouse.

GST

- Tax rate in pre-GST era was ~18% for imports, while it was ~22% for self-manufactured goods in India, while the rate under GST is 28%.
- Management guided that the market is absorbing the price hike. Performance in August was strong while September will also likely exceed the target despite being a seasonally slow month.

- GST will be beneficial for logistics as transportation speeds up.
- Management explained that Q1 was impacted majorly by GST implementation due to de-stocking and slowdown in CSD segment. PBT of INR700-750mn could have been achieved if not for the implementation of GST (actual PBT INR605mn).

Bangladesh

- VIP has announced capex of INR250mn to double capacity in Bangladesh (currently ~70,000 units/month) to reduce sourcing from China. This will improve margin as labour costs are significantly lower in Bangladesh (~1/6th) and it will capture manufacturing margins as opposed to just trading margin in sourcing from China.
- The company had earlier invested ~INR200mn in the first Bangladesh plant, which has turned around strongly after tough first 2 years. Bangladesh subsidiary now makes ~20% PAT margin (versus VIP consolidated PAT margin of 7-8%). PAT from Bangladesh subsidiary stood at INR95mn in FY17.
- Raw material is sourced from China. However, it is the labour cost in manufacturing that provides substantial arbitrage.
- Imports from Bangladesh do not attract import duty (10%) due to its status as an under-developed country, which further provides arbitrage versus sourcing from China. This will further open up opportunities for VIP's international business.

Brands

- *Skybags* continue to grow strongly, particularly in hypermarkets, and has now become VIP's biggest brand. Further, *Skybags* has highest ad spends.
- *Aristocrat*, VIP's value brand, has also done well following increased focus on marketing. Management may consider merging *Alfa* and *Aristocrat* as they cater to the same segment.
- All brands generate positive earnings now.
- VIP will continue to incur brand spends at around 7% of revenue and see it as an essential expense to build brands. Ad spends will be around INR1bn in FY18. High margin *Carlton* and *Caprese* incur brand spends of around 35%.
- VIP has gone from negligible presence in backpacks 5 years ago to being a market leader currently. Market size for backpacks could be around ~INR10bn. Wildcraft is big in backpacks with sales of around INR1.5bn. However, the company is not yet making profits.

Channels

- Retailing is expensive for the luggage industry due to the nature and size of the product, being a slow moving item. Hence, retail margin can be as high as 35-40% on sales. These high margins are an entry barrier for new players.
- CSD channel which used to contribute ~25% of business has slowed down significantly due to GST. Distribution margin is mere ~5%, while 50% of GST is exempt in this segment. The segment had no sales in June.
- CSD was slow in the past year or so due to government strategy to clean up the channel from leakages.

- Hypermarkets channel has been growing strongly at 40-50%, where *Skybags'* growth has been 30-40%. VIP has ~60% market share in hypermarkets. This channel is a significant growth driver for it, and also the most profitable channel along with CSD.
- VIP currently has ~500 VIP retail stores, out of which half are self-run and half franchisee run.
- E-commerce is also doing well. VIP did around INR100mn sales in August.

Competition

- Samsonite enjoys market share of ~38% in India. They are market leaders in all countries (~130) that they have entered, except for India.
- VIP has >40% market share in CSD channel. All competitors are also present in this channel, however it forms much bigger part of Samsonite's revenue share than for VIP.

Change in Estimates

	FY18E			FY19E			
	New	**Old**	***% change***	**New**	**Old**	***% change***	**Comments**
Net Revenue	14,536	14,165	*2.6*	16,974	16,442	*3.2*	
EBITDA	1,632	1,638	*(0.4)*	2,116	2,016	*4.9*	Shift towards manufacturing will lead to margin expansion
EBITDA Margin	*11.2*	*11.6*		*12.5*	*12.3*		
Adjusted Profit After Tax	1,060	1,064	*(0.4)*	1,391	1,326	*4.9*	
Net Profit Margin	*7.3*	*7.5*		*8.2*	*8.1*		
Capex	254	254	*0.0*	230	80	*187.5*	

Company Description

VIP, the flagship company of DG Piramal Group, was established in 1968. It began manufacturing suitcases in 1971. The company operates in luggage and moulded furniture segments. The company manufactures a range of hard-sided and soft-sided luggage including trolleys, suitcases, duffels and overnight travel solutions, executive cases, backpacks and school bags. Key brands are VIP, Skybags, Alfa, Aristocrat, Carlton, Caprese. The company's manufacturing facilities are located at Nashik and in Haridwar (Uttarakhand).

Investment Theme

VIP, which began as a moulding furniture company in 1970, is now the second largest player in the world and largest in Asia commanding ~50% market share in luggage market in India, followed by Samsonite and Safari. Manufacturing forms around 25% of their total sourcing which the company is looking to increase, adding further capacity in Bangladesh. This will add manufacturing margins as opposed to just trading margins earlier. The company is present across segments through *Aristocrat* and *Alfa* in value segment, *VIP* and *Skybags* in mid segment, *Carlton* in premium segment and *Caprese* in handbags.

Key Risks

Stiff competition from organised sector

Increase in competition from the organised sector can affect VIP's sales and profitability growth as players like Samsonite post having grown strong in market share are now focused on profitability, while players like Safari are strongly focused on gaining market share.

Increase in raw material prices

The company currently derives ~20% of its revenues from hard luggage that is manufactured in-house. Major raw materials consumed in manufacture of hard luggage are polypropylene and aluminum. Any substantial rise in their prices will adversely impact the company's margins and, hence, profitability.

Fluctuation in exchange rates, particularly appreciation of Yuan

Any appreciation in Yuan could hit VIP's realizations as the company imports most of its soft luggage (70% of sales) from China. Also, the impact of currency depreciation, is passed with a lag. In this context, appreciation of the Yuan is particularly harmful for earnings.

Working capital increase from growing modern trade

Working capital of the company can deteriorate if the modern trade channel grows aggressively.

Financial Statements

Key Assumptions

Year to March	FY16	FY17	FY18E	FY19E
Macro				
GDP(Y-o-Y %)	7.9	6.6	6.8	7.4
Inflation (Avg)	4.9	4.5	4.0	4.5
Repo rate (exit rate)	6.8	6.3	5.8	5.8
USD/INR (Avg)	65.5	67.1	65.0	66.0
Company				
Domestic growth	16.3	6.5	15.0	17.0
Exports	15.0	(13.0)	2.0	14.0
Raw Material (% net rev)	54.5	53.0	52.5	51.8
Employee cost (% of rev)	10.3	11.1	10.8	10.5
Selling exp.(% Net Rev)	26.3	25.6	25.5	25.2
Avg. Interest rate (%)	5.2	8.0	8.0	8.0
Depreciation rate (%)	5.1	4.8	4.7	4.7
Tax rate (%)	30.1	32.1	32.0	32.0
Soft luggage %	79.0	79.0	84.0	84.0
Hard luggage %	21.0	21.0	16.0	16.0
Net borrowings (INR mn)	143	-	50	50
Capex (INR mn)	21	70	220	250
Debtor days	39	39	35	36
Inventory days	142	154	145	145
Payable days	77	83	75	75
Cash conversion cycle	104	110	105	106

Income statement (INR mn)

Year to March	FY16	FY17	FY18E	FY19E
Net revenue	12,165	12,752	14,536	16,974
Materials costs	6,627	6,760	7,628	8,799
Gross profit	5,537	5,992	6,908	8,175
Employee costs	1,259	1,415	1,570	1,782
Other Expenses	3,200	3,259	3,707	4,277
Total operating expenses	11,086	11,434	12,904	14,859
EBITDA	1,079	1,318	1,632	2,116
Depreciation	142	136	139	151
EBIT	937	1,182	1,492	1,965
Add: Other income	25.7	59.1	68.66	84.24
Less: Interest Expense	12	6	2	4
Profit Before Tax	951	1,235	1,559	2,045
Less: Provision for Tax	287	397	499	655
Reported Profit	665	839	1,060	1,391
Adjusted Profit	665	839	1,060	1,391
Shares o /s (mn)	141	141	141	141
Adjusted Basic EPS	4.7	5.9	7.5	9.8
Diluted shares o/s (mn)	141	141	141	141
Adjusted Diluted EPS	4.7	5.9	7.5	9.8
Adjusted Cash EPS	5.6	6.9	8.7	11.2
Dividend per share (DPS)	2.0	2.4	3.0	4.0
Dividend Payout Ratio(%)	51.2	48.5	48.0	48.8

Common size metrics

Year to March	FY16	FY17	FY18E	FY19E
Operating expenses	36.7	36.7	36.3	35.7
Cost of goods sold	54.5	53.0	52.5	51.8
Depreciation	1.2	1.1	1.0	0.9
Interest Expense	0.1	-	-	-
EBITDA margins	8.9	10.3	11.2	12.5
Net Profit margins	5.5	6.6	7.3	8.2

Growth ratios (%)

Year to March	FY16	FY17	FY18E	FY19E
Revenues	16.1	4.8	14.0	16.8
EBITDA	39.3	22.2	23.8	29.7
PBT	45.2	29.9	26.2	31.2
Adjusted Profit	52.5	26.2	26.4	31.2
EPS	52.5	26.2	26.4	31.2

Balance sheet (INR mn)

As on 31st March	FY16	FY17	FY18E	FY19E
Share capital	283	283	283	283
Reserves & Surplus	3,111	3,801	4,352	5,065
Shareholders' funds	3,393	4,084	4,635	5,348
Long term borrowings	143	-	50	50
Total Borrowings	143	-	50	50
Long Term Liabilities	69	97	106	115
Def. Tax Liability (net)	(41)	(51)	(51)	(51)
Sources of funds	**3,564**	**4,129**	**4,739**	**5,461**
Gross Block	2,787	2,857	3,077	3,327
Net Block	656	600	680	780
Capital work in progress	11	6	40	20
Intangible Assets	10	11	11	11
Total Fixed Assets	677	616	731	811
Non current investments	-	-	-	-
Cash and Equivalents	80	785	1,219	1,529
Inventories	2,874	2,826	3,239	3,736
Sundry Debtors	1,493	1,210	1,553	1,814
Loans & Advances	630	558	596	638
Other Current Assets	53	45	50	55
Current Assets (ex cash)	5,051	4,639	5,438	6,243
Trade payable	1,608	1,457	1,672	1,928
Other Current Liab	636	454	977	1,193
Total Current Liab	2,244	1,912	2,648	3,121
Net Curr Assets-ex cash	2,807	2,728	2,790	3,121
Uses of funds	**3,564**	**4,129**	**4,739**	**5,461**
BVPS (INR)	24.0	28.9	32.8	37.8

Free cash flow (INR mn)

Year to March	FY16	FY17	FY18E	FY19E
Reported Profit	665	839	1,060	1,391
Add: Depreciation	142	136	139	151
Interest (Net of Tax)	8	4	1	3
Others	(584)	603	(151)	(700)
Less: Changes in WC	304	(319)	54	322
Operating cash flow	534	1,263	1,104	1,167
Less: Capex	88	82	254	230
Free Cash Flow	**446**	**1,181**	**849**	**937**

Cash flow metrics

Year to March	FY16	FY17	FY18E	FY19E
Operating cash flow	534	1,263	1,104	1,167
Investing cash flow	(84)	(729)	(210)	(174)
Financing cash flow	(447)	(513)	(461)	(682)
Net cash Flow	3	21	433	311
Capex	(88)	(82)	(254)	(230)
Dividend paid	(270)	(366)	(509)	(678)

Profitability and efficiency ratios

Year to March	FY16	FY17	FY18E	FY19E
ROAE (%)	20.6	22.4	24.3	27.9
ROACE (%)	27.9	32.6	35.6	40.7
ROA	19.1	21.8	23.9	27.3
Debt/EBITDA (x)	0.1	-	-	-
Debt/Equity (x)	-	-	-	-
Interest Coverage Ratio	79.4	207.4	746.1	491.3
Debt / Cap employed (%)	65.8	45.1	55.9	57.1

Operating ratios

Year to March	FY16	FY17	FY18E	FY19E
Total Asset Turnover	3.5	3.3	3.3	3.3
Fixed Asset Turnover	17.6	20.0	22.3	22.9
Equity Turnover	3.8	3.4	3.3	3.4

Valuation parameters

Year to March	FY16	FY17	FY18E	FY19E
Adj. Diluted EPS (INR)	4.7	5.9	7.5	9.8
Y-o-Y growth (%)	*52.5*	*26.2*	*26.4*	*31.2*
Adjusted Cash EPS (INR)	5.6	6.9	8.7	11.2
Diluted P/E (x)	52.8	41.9	33.1	25.2
P/B (x)	10.3	8.6	7.6	6.6
EV / Sales (x)	2.9	2.7	2.3	2.0
EV / EBITDA (x)	32.6	26.0	20.8	15.9
Dividend Yield (%)	0.8	1.0	1.2	1.6

Additional Data

Directors Data

Dilip G Piramal	Chairman & Managing Director	Radhika Piramal	Vice Chairperson & Executive Director
Ashish K Saha	Director Works	DK Poddar	Independent - Non-Executive Director
Vijay Kalantri	Independent - Non-Executive Director	G.L. Mirchandani	Independent - Non-Executive Director
Nabankur Gupta	Independent - Non-Executive Director	Rajeev Gupta	Independent - Non-Executive Director
Amit Jatia	Independent - Non-Executive Director		

Auditors - Price Waterhouse Chartered Accountants LLP

Holding Top -10

	Perc. Holding		Perc. Holding
SBI Funds	4.11	Religare India AMC	1.45
Reliance Capital	3.03	Dimensional Fund Advisors	1.18
Templeton Asset Management	2.35	ICICI Pru AMC	0.86
Birla Sun Life AMC	2.10	Van Eck Associates	0.28
HDFC Asset Management	1.55	LIC Nomura Mutual Fund	0.19

**as per last available data*

Bulk Deals

Data	Acquired / Seller	B/S	Qty Traded	Price
No Data Available				

**as per last available data*

Insider Trades

Reporting Data	Acquired / Seller	B/S	Qty Traded
No Data Available			

**as per last available data*

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Coverage group(s) of stocks by primary analyst(s): *Miscellaneous*

AIA Engineering, Apar Industries Ltd, Aarti Industries, Agro Tech Foods, Balkrishna Industries, CCL Products India, Essel Propack, Orient Refractories, Supreme Industries, Solar Industries, SRF, Vesuvius India, VIP Industries

Recent Research

Date	Company	Title	Price (INR)	Recos
08-Sep-17	**Apar Industries**	Near term pain; structural drivers intact; *Visit Note*	786	Buy
16-Aug-17	**AIA Engineering**	Volumes to remain strong; margins plummet; *Result Update*	1,406	Buy
14-Aug-17	**Apar Industries**	Temporary pre-GST hiccups; *Result Update*	750	Buy

Distribution of Ratings / Market Cap

Edelweiss Research Coverage Universe

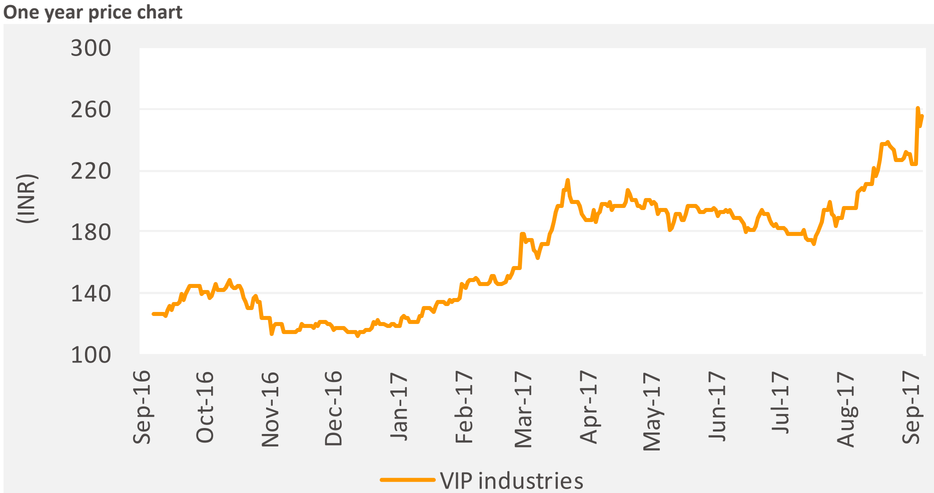
	Buy	Hold	Reduce	Total
Rating Distribution* * 1stocks under review	161	67	11	240

	> 50bn	Between 10bn and 50 bn	< 10bn
Market Cap (INR)	156	62	11

Rating Interpretation

Rating	Expected to
Buy	appreciate more than 15% over a 12-month period
Hold	appreciate up to 15% over a 12-month period
Reduce	depreciate more than 5% over a 12-month period

One year price chart



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